II. THE SECOND CIRCUIT PROPERLY CONSTRUED *BLUE CHIP STAMPS* AS A LIMIT ON SLUSA PREEMPTION.

In *Blue Chip Stamps*, this Court held that private securities litigation under Section 10(b) and Rule 10b-5 is limited to claims based upon the actual purchase or sale of securities.[4] *Blue Chip Stamps*, 421 U.S. at 749; *see also Superintendent of Ins. of New York v. Bankers Life & Cas. Co.*, 404 U.S. 6, 10 (1971) (plaintiffs' injuries must result from deceptive practices "in connection with," or that touch plaintiffs purchase or sale of securities). In so holding, this Court expressed concern that an expansion of federal securities litigation beyond actual purchasers and sellers of securities could result in "endless case-by-case erosion" of the statutory language, which explicitly limits the reach of Section 10(b) and Rule 10b-5 to the "purchase or sale of any security." *See Blue Chip Stamps*, 421 U.S. at 755; *accord SEC v. Zandford*, 535 U.S. 813, 820 (2003) ("in connection with" provision "must not be construed so broadly as to convert every common-law fraud that happens to involve securities into a violation of § 10(b)").

---

[4] Specifically, *Blue Chip Stamps* affirmed the correctness of the "Birnbaum rule," established by the Second Circuit, which it characterized as follows:

> Since both § 10(b) and Rule 10b-5 proscribed only fraud "in connection with the purchase or sale" of securities, and since the history of § 10(b) revealed no congressional intention to extend a private civil remedy for money damages to other than defrauded purchasers or sellers of securities, in contrast to the express civil remedy provided by § 16(b) of the 1934 Act, the court concluded that the plaintiff class in a Rule 10b-5 action was limited to actual purchasers and sellers.

421 U.S. at 731.

Given that claims of nonpurchasers and nonsellers have been left to state law, and given SLUSA's language and specific purpose, the Second Circuit properly rejected Merrill's argument that the *Blue Chip Stamps*' purchaser-seller rule applies only to standing under the federal securities laws and not to SLUSA's substantive application. The same statutory limitation found in the securities laws and addressed in *Blue Chip Stamps* is found in SLUSA, which limits preemption to claims "in connection with the purchase or sale of a covered security." 15 U.S.C. § 77p(b) and § 78bb(f)(1). The Second Circuit reasoned that, in choosing the "in connection with" language of Section 10(b), "Congress employed language with a settled judicial interpretation of which *Blue Chip* was a part and we see no clear indication either in the text or the legislative history of SLUSA of a congressional intent to abolish nonpurchaser and nonseller state class action claims." *Dabit*, 395 F.3d at 39. To the contrary, since only purchasers and sellers have access to a private damages remedy under federal law, as the Second Circuit concluded, "it is far more natural to suppose that Congress meant to import the settled standing rule along with the 'in connection with' phrase as a substantive standard." *Id.* at 40.

Merrill further argues that policy considerations weigh heavily against the Second Circuit's interpretation, arguing, *inter alia*, that it would allow certain categories of "vexatious" litigation to go forward. *See* Merrill Petition at 40 ("Holder claims present the greatest risk for the type of vexatious securities litigation that Congress sought to eliminate when it enacted SLUSA."). This Court cannot

import into the statute a policy consideration where Congress itself failed to do so. As the Second Circuit noted:

> The question in interpreting ambiguous statutory language, however, is not what Congress might sensibly want to do, but what Congress did. . . . As noted, Congress defined SLUSA's preemptive scope by borrowing language with a settled judicial interpretation in the context of private damages actions, and such borrowing implicates the strong presumption that Congress is aware of and approves that construction. Under that construction, the Supreme Court held that the judicially-adopted bar on federal non-purchaser and non-seller claims was counterbalanced by the existence of remedies under state law.

Dabit, 395 F.3d at 40 (citations omitted).

Consistent with the Court's holding in *Blue Chip Stamps* and other precedent interpreting the language of Section 10(b) and Rule 10b-5 as applied to private plaintiffs, SLUSA preemption does not extend to claims that do not allege a purchase or sale of covered securities. *See Green*, 279 F.3d at 598; *Gordon v. Buntrock*, No. 00 CV 303 (SAS), 2000 WL 556763, at *14 (N.D. Ill. April 28, 2000).

Merrill contends that a plain reading of SLUSA would allow for preemption of claims, such as Dabit's "holding" claims even though no purchase or sale of a security took place. *See* Merrill Petition at 21. To the contrary, Merrill's argument that claims such as Dabit's, which involve no purchase or sale of a security, should be preempted unreasonably re-writes SLUSA. Congress did not make SLUSA applicable to claims that are "in connection with securities." Rather, the statute applies to claims "in connection

with the *purchase* or *sale*" of securities. *See* 15 U.S.C. § 77p(b) and § 78bb(f) (emphasis added). A number of cases applying SLUSA's scope have looked to whether the state law claims are based on a purchase or sale of securities.

In the typical securities case that Congress sought to address in SLUSA, the claim is that the defendant misrepresented the value of a particular stock, thereby causing the plaintiff to purchase the stock and suffer damages caused by a drop in stock price. *See Spielman v. Merrill Lynch, Pierce, Fenner & Smith*, No. 01-Civ. 3013 (DLG), 2001 U.S. Dist. LEXIS 15943, *9-10 (S.D.N.Y. Oct. 9, 2001). Courts confronted with this fact pattern routinely find that the misrepresentation at issue is "in connection with" the purchase or sale of securities. *Id.* at *10. Accordingly, when the same fact pattern is alleged in support of state law claims, courts routinely find the SLUSA "in connection with" requirement satisfied and the claim preempted. *See, e.g., Riley*, 292 F.3d at 1347.[5]

In other securities cases, while the misrepresentation at issue may not concern the value of a particular stock, *per se*, the claim nevertheless involves the purchase or sale of a particular stock as a result of the misrepresentation. *See, e.g., Arrington v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 651 F.2d 615 (9th Cir. 1981); *Marbury Mgmt., Inc. v. Kohn*, 629 F.2d 705 (2d Cir. 1980). There are similar cases in the SLUSA context, *i.e.*, cases where the misrepresentation is not about the value of the stock *per se*, but

[5] *See also Feitelberg v. Merrill Lynch & Co., Inc.*, 234 F. Supp. 2d 1043 (N.D. Cal. 2002) (plaintiffs sought "restitution" of trading losses as well as "disgorgement" of profits); *Korsinsky v. Salomon Smith Barney Inc.*, 2002 WL 27775 (S.D.N.Y. January 10, 2002) (plaintiffs sought damages in the form of investment losses).

there is an allegation that an alleged misrepresentation caused the purchase of securities. *See, e.g., Behlen v. Merrill Lynch*, 311 F.3d 1087 (11th Cir. 2002); *Dudek v. Prudential Sec., Inc.*, 295 F.3d 875 (8th Cir. 2002).

However, SLUSA preemption does not extend to state law claims without a purchase or sale of securities. For example, in *Green v. Ameritrade, Inc.*, 279 F.3d 590 (8th Cir. 2002), the plaintiff alleged that his broker promised to provide him with access to "real time" stock quotes, but failed to deliver the information as promised. In the initial complaint, the *Green* plaintiff alleged that he purchased or sold securities, but omitted those allegations after the district court gave him the opportunity to amend the complaint. *Id.* at 598. The defendant argued that, even though the plaintiff had not alleged that he bought securities based on the real time quotes, the purpose of the quotes was to assist in determining what securities to buy and, thus, delivery of the quotes was in connection with the purchase and sale of securities. *Id.* at 597. The Eighth Circuit, however, concluded that SLUSA did not preempt the amended complaint, rejecting the suggestion that a purchase or sale should be read into the amended complaint. *Id.* at 599.

The Eighth Circuit explained that it was not enough that the product was generally of the type relied upon by investors. Instead, there must be an allegation that someone purchased or sold the stock in reliance on the quotes in order to satisfy the "in connection with" requirement under SLUSA. The court explained:

> [Defendant] does not argue that [the plaintiff's] amended complaint alleges that he or putative class members used price information provided by the real-time quote service to purchase or sell

> any particular security; instead, [defendant] asserts that consumers in general use that kind of information to purchase and sell securities, and therefore SLUSA applies to the provision of that information in this case. This argument highlights [defendant's] failure to understand the showing necessary to satisfy the "in connection with the sale or purchase of a covered security" criterion of SLUSA.
>
> * * *
>
> [T]he critical question is whether [the plaintiff's] amended complaint can reasonably be read as alleging a sale or purchase of a covered security made in reliance on the allegedly faulty information provided to himself and to putative class members by [defendant].

Green, 279 F.3d at 597-98. Thus, the court held that the plaintiff's claim was not "in connection with" a purchase or sale of securities because there was no purchase or sale of securities.

III. THIS COURT'S DECISION IN *SEC V. ZANDFORD* DOES NOT EXPAND THE SCOPE OF THE SLUSA PREEMPTION.

Contrary to Merrill's assertion, this Court's holding in *SEC v. Zandford*, 535 U.S. 813 (2002), does not change the analysis of SLUSA's preemption. *See* Merrill Petition at 25. In *Zandford*, the SEC alleged that the defendant engaged in a scheme to defraud an investor whereby he wrongfully sold stock to convert it for his own benefit. 535 U.S. at 815. In that case, the issue before this Court was whether, in the context of a motion to dismiss, the SEC had adequately pleaded a claim. *Id.* at 818. Although this Court in *Zandford* held that the alleged deceptive practice

was "in connection with" the purchase or sale of securities, *id.* at 825, the Court stated that its holding should not convert every claim against a broker into a federal securities claim, *id.* at 825 n.4. Likewise, *Zandford* cannot be read so broadly that SLUSA applies to preempt claims of a private plaintiff, irrespective of whether the plaintiff alleges a purchase or sale of securities.

CONCLUSION

For the foregoing reasons, this Court should uphold the decision of the United States Court of Appeals for the Second Circuit.

Respectfully submitted,

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Supreme Court of the United States

MERRILL LYNCH, PIERCE, FENNER & SMITH, INC.,
Petitioner,

v.

SHADI DABIT,
Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Second Circuit

BRIEF FOR THE INVESTMENT COMPANY INSTITUTE AS AMICUS CURIAE IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Whether class actions brought under state law by non-transacting "holders" of securities are precluded by the Securities Litigation Uniform Standards Act of 1998 (SLUSA).

TABLE OF CONTENTS

INTEREST OF AMICUS 1
STATEMENT 3
SUMMARY OF ARGUMENT 4
ARGUMENT 6
CONCLUSION 19

TABLE OF AUTHORITIES

Cases

A.C. Frost & Co. v. *Coeur d'Alene Mines Corp.*,
312 U.S. 38 (1941) 10

Amzak Corp. v. *Reliant Energy, Inc.*,
No. 03-C0877, 2004 U.S. Dist. LEXIS
16514 (N.D. Ill. Aug. 18, 2004) 15

Arent v. *Distrib. Sci., Inc.*,
975 F.2d 1370 (8th Cir. 1992) 13, 15

Arnlund v. *Deloitte & Touche LLP*,
199 F. Supp. 2d 461 (E.D. Va. 2002) 15

Blue Chip Stamps v. *Manor Drug Stores*,
421 U.S. 723 (1975) ..... *passim*

Carpenter v. *United States*,
484 U.S. 19 (1987) 10

Central Bank of Denver, N.A. v. *First Interstate
Bank of Denver, N.A.*,
511 U.S. 164 (1994) 11

Chanoff v. *United States Surgical Corp.*,
857 F. Supp. 1011 (D. Conn.),
aff'd, 33 F.3d 50 (2d Cir. 1994) 15

Chiarella v. *United States*,
445 U.S. 222 (1980) 8

Crocker v. *FDIC*,
826 F.2d 347 (5th Cir. 1987) 13, 15

CSX Transp., Inc. v. *Easterwood*,
507 U.S. 658 (1993) 14

Davis v. *Mich. Dep't of Treasury*,
489 U.S. 803 (1989) 9

Dura Pharms., Inc. v. *Broudo*,
125 S. Ct. 1627 (2005) 10

Gordon v. *Buntrock*,
No. 00CV303, 2000 U.S. Dist. LEXIS 5977
(N.D. Ill. Apr. 28, 2000) 16

Gustafson v. *Alloyd Co.*,
513 U.S. 561 (1995) 7

Holmes v. *SIPC*,
503 U.S. 258 (1992) 8, 14

In re Silicon Graphics Sec. Litig.,
183 F.3d 970 (9th Cir. 1999) 3

Kircher v. *Putnam Funds Trust*,
403 F.3d 478 (7th Cir. 2005),
cert. pending, No. 05-409 ..... 4, 8, 17

Lampf, Pleva, Lipkind, Prupis & Petigrow v.
Gilbertson,
501 U.S. 350 (1991) 11

Lander v. *Hartford Life & Annuity Ins. Co.*,
251 F.3d 101 (2d Cir. 2001) 14

Malone v. *Brincat*,
722 A.2d 5 (Del. 1998) 12

Manzo v. *Rite Aid Corp.*,
No. 18451-NC, 2002 Del. Ch. LEXIS 147
(Dec. 19, 2002),
aff'd, 825 A.2d. 239 (Del. 2003) 13

Pittston Coal Group v. *Sebben*,
488 U.S. 105 (1988) 15

Riley v. *Merrill Lynch, Pierce, Fenner & Smith*,
292 F.3d 1334 (11th Cir. 2002) 3

Rogers v. *Cisco Sys., Inc.*,
268 F. Supp. 2d 1305 (N.D. Fla. 2003) 15

Schuster v. *Gardner*,
127 Cal. App. 4th 305 (2005) 13

SEC v. *Zandford*,
535 U.S. 813 (2002) 5, 7

Shirvanian v. *DeFrates*,
No. 04-02-0447-CV2004 Tex. App. LEXIS
182 (Jan. 8, 2004),
vacated on other grounds, 161 S.W.3d 102
(Tex. App. 2004) 15

Small v. *Fritz Cos.*,
30 Cal. 4th 167 (Cal. 2003) 15, 16

United States v. *Naftalin*,
441 U.S. 768 (1979) 4, 9

United States v. *O'Hagan*,
521 U.S. 642 (1997) 5, 9, 10

Weinstein v. *Ebbers (In re WorldCom, Inc. Sec. Litig.)*,
336 F. Supp. 2d 310 (S.D.N.Y. 2004) 15

WM High Yield Fund v. *O'Hanlon*,
No. 04-3423, 2005 U.S. Dist. LEXIS 12064
(E.D. Pa. May 13, 2005) 15

Statutes

Insider Trading & Secs. Fraud Enforcement Act
of 1988, Pub. L. No. 100-704, 102 Stat.
4677, 4680-81 (15 U.S.C. § 78t-1) 10

National Secs. Markets Improvement Act of
1996, Pub. L. No. 104-290, 110 Stat. 3416:

15 U.S.C. § 77r(c)(1) 2

Private Secs. Litig. Reform Act of 1995, Pub. L. No. 104-67, 109 Stat. 737:

15 U.S.C. § 77z-1(a) 17

15 U.S.C. § 77z-1(b) 3

15 U.S.C. § 78u-4(a) 17

15 U.S.C. § 78u-4(b)(1) 3

15 U.S.C. § 78u-4(b)(2) 3

15 U.S.C. § 78u-4(b)(3) 3

Secs. Litig. Uniform Standards Act of 1998, Pub. L. No. 105-353, 112 Stat. 3227 ..... 3, 16

15 U.S.C. § 77p(b) 4

15 U.S.C. § 77p(d)(2) 13

15 U.S.C. § 77p(d)(3) 12

15 U.S.C. § 77p(f)(2) 13

15 U.S.C. § 77p(f)(2)(B) 13

15 U.S.C. § 78bb(f)(1) 4

15 U.S.C. § 78bb(f)(3)(B) 13

15 U.S.C. § 78bb(f)(3)(C) 12

15 U.S.C. § 78bb(f)(5)(B) 13

15 U.S.C. § 78bb(f)(5)(C) 13

28 U.S.C. § 1658 12

Miscellaneous

144 Cong. Rec. H. 6052 (1998) 11

144 Cong. Rec. S. 4778 (1998) 11, 12

H.R. Conf. Rep. No. 105-803 (1998) 3, 7

H.R. Rep. No. 104-369 (1995) 3, 7, 18

S. Rep. No. 105-182 (1998) 11, 12

Testimony of U.S. Secs. & Exch. Comm'n Concerning S. 1260, The "Secs. Litig. Uniform Standards Act of 1997" Before the S. Banking Subcomm., 105th Cong. 21 (1997) 11, 12

Timothy J. Burger, *New Securities Reform Fight Looms*, The Recorder, Apr. 16, 1997, at 1 16

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ICI, *2005 Investment Company Fact Book* 1, 2, 17

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BRIEF FOR THE INVESTMENT COMPANY INSTITUTE AS AMICUS CURIAE IN SUPPORT OF PETITIONER

The Investment Company Institute (ICI), as *amicus curiae*, respectfully submits that the decision below should be reversed insofar as it holds that state-law "holder" class actions are not precluded by federal law.[1]

INTEREST OF AMICUS

ICI is the national association of the United States investment company industry. ICI's members include mutual funds, closed-end investment companies, exchange-traded funds, and unit investment trusts. ICI's mutual fund members manage more than eight trillion dollars on behalf of 90 million individual investors in nearly half of American households. ICI, *2005 Investment Company Fact Book* 3 & 29, http://www.ici.org/statements/res-/2005_factbook.pdf. Due to their diversification, professional management, and varying investment objectives, mutual funds are the investment vehicle of choice for great numbers of Americans from every walk of life, particularly as they build savings for retirement security. Today, mutual funds make up 43 percent

[1] Pursuant to this Court's Rule 37.6, ICI states that no party's counsel authored this brief in whole or in part, and no person or entity, other than ICI and its members, made a monetary contribution to the preparation or submission of this brief. Counsel of record for both petitioner and respondent have consented to the filing of this brief in letters that have been lodged with the Clerk.

of the $3.5 trillion in IRAs and about half of the $2.1 trillion in 401(k) plans. *Id.* at 39 & 41.

ICI members are significant issuers of securities. In recent years, long-term mutual funds have sold more than $1.4 trillion in new shares annually. *2005 Investment Company Fact Book* 76-77. Unlike other issuers, mutual fund operations are subject to each of the four major federal securities laws. Mutual funds are registered with the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940, which subjects them to detailed statutory and regulatory prescriptions regarding their structure, operations, and governance; mutual fund shares must be registered under the Securities Act of 1933; the offer and sale of mutual fund shares are governed by the Securities Exchange Act of 1934; and the investment advisers to mutual funds are regulated under the Investment Advisers Act of 1940. In addition to this comprehensive federal regulation of mutual funds, each State's securities regulator has authority to investigate and bring enforcement actions with respect to fraud and deceit. 15 U.S.C. § 77r(c)(1).

ICI members are also significant purchasers, sellers, and holders of nationally traded securities. On average, ICI members account for 10 percent or more of the annual dollar volume of stock purchases and sales on the U.S. stock exchanges. Moreover, mutual funds hold 22 percent of the outstanding corporate equity in the United States, as well as large amounts of publicly traded debt securities. *2005 Investment Company Fact Book* 6-7.

Since ICI's founding over 60 years ago, one of its main objectives has been to protect and affirmatively advance the interests of mutual fund shareholders through advocacy directed at ensuring a sound legal and regulatory framework for the mutual fund industry. In pursuit of this objective, ICI regularly engages in legislative, regulatory, and other initiatives aimed at increasing government and public awareness of issues affecting investment companies and their shareholders.

STATEMENT

In 1995, Congress enacted the Private Securities Litigation Reform Act (PSLRA) to deter meritless lawsuits alleging securities fraud. *See, e.g.*, H.R. Conf. Rep. No. 104-369, at 31-32 (1995); *In re Silicon Graphics Sec. Litig.*, 183 F.3d 970, 978-79 (9th Cir. 1999). Among other significant reforms, the PSLRA imposed new and rigorous pleading requirements for securities fraud actions (15 U.S.C. § 78u-4(b)(1)-(2)) and an automatic stay of discovery until any motions to dismiss have been resolved (15 U.S.C. §§ 77z-1(b) & 78u-4(b)(3)). To avoid the PSLRA requirements, securities plaintiffs increasingly began filing suit in state court, where the PSLRA does not apply. *Riley* v. *Merrill Lynch, Pierce, Fenner & Smith*, 292 F.3d 1334, 1341 n.12 (11th Cir. 2002) ("the decline in federal securities class action suits that occurred after the passage of the PSLRA was accompanied by a nearly identical increase in state court filings"); *see* H.R. Conf. Rep. No. 105-803, at 14 (1998) ("Prior to the passage of the [PSLRA], there was essentially no significant securities class action litigation brought in State court"). These state-court lawsuits presented precisely the opportunities for abuse that Congress had sought to curb by enacting the PSLRA. *Id.* at 13-14.

In response to this widespread evasion of the PSLRA by state-court litigation, Congress enacted the Securities Litigation Uniform Standards Act of 1998 (SLUSA) to "establish[] uniform national rules for securities class action litigation involving our capital markets." H.R. Conf. Rep. No. 105-803, at 13. In so doing, Congress explained that "in order to prevent certain State private securities class action lawsuits alleging fraud from being used to frustrate the objectives of the [PSLRA], it is appropriate to enact national standards for securities class action lawsuits involving nationally traded securities." SLUSA § 2(5), 112 Stat. 3227. To accomplish this goal, SLUSA provides that "[n]o covered class action based upon the statutory or common law of any State ... may be maintained in any State or Federal court by any private party alleging" misrepresentations or manipulation "in

connection with the purchase or sale" of covered securities, including mutual fund shares. 15 U.S.C. §§ 77p(b) & 78bb(f)(1).

SLUSA's description of the class actions within its preclusive reach—*i.e.*, those alleging a "misrepresentation or omission of a material fact," or a "manipulative or deceptive device or contrivance," occurring "in connection with the purchase or sale" of securities—was borrowed from Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, the basic anti-fraud provisions of the federal securities laws. In *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723 (1975), this Court held that a private plaintiff cannot maintain a Rule 10b-5 action unless the plaintiff is a purchaser or seller of securities. This judicially created rule of standing is "inapplicable," however, in actions to enforce Rule 10b-5 by public prosecutors. *United States* v. *Naftalin*, 441 U.S. 768, 774 n.6 (1979). The question in this case is what relevance, if any, the *Blue Chip Stamps* purchaser/seller standing limitation has to the scope of SLUSA preclusion. Pet. i.

The court below held that "the purchaser-seller rule of [*Blue Chip Stamps*] applies as a limit on SLUSA's 'in connection with' requirement such that SLUSA does not preempt claims that do not allege purchases or sales made by the plaintiff or the alleged class members." Pet. App. 4a. The Seventh Circuit, by contrast, has concluded that "SLUSA is as broad as § 10(b) itself and that limitations on private rights of action to enforce § 10(b) and Rule 10b-5"—including particularly the *Blue Chip Stamps* purchaser/seller standing limitation—"do not open the door to litigation about securities transactions under state law." *Kircher* v. *Putnam Funds Trust*, 403 F.3d 478, 484 (7th Cir. 2005), *cert. pending*, No. 05-409.

SUMMARY OF ARGUMENT

SLUSA provides that class actions alleging securities fraud must proceed in federal court pursuant to the PSLRA, if at all; at the same time, it expressly exempts a number of